2013 Insurance Committee Report

Employee Misclassification Advisory Taskforce

(7) Whether there are new ways to pool, focus and target investigative and enforcement resources relative to employee misclassification.

A critical strategy to aid in the investigation of employers' failure to properly classify their employees is the employment of technology in the form of a software program to concentrate efforts on high risk employers. Our objective was to thoroughly research software solutions for cross checking databases in order to identify fraudulent misclassification activity in Tennessee. Secondly, we sought to draw a conclusion as to whether it is in the best interests of the state of Tennessee to invest in a software package to aid investigators in the apprehension and punishment of fraud perpetrators.

The following vendor feedback was provided along with approximate system costs:

Risk Metrics & Insurance TechKNOWLEDGEy Joint Venture

According to an October 24, 2012 web presentation, Risk Metrics and Insurance TechKNOWLEDGEy would form a joint venture to deliver their software package to the Department of Labor and Workforce Development. Risk Metrics believes Tennessee is already on its way to improving collaborative governance. As such, Tennessee would submit POC (proof of coverage) data to Risk Metrics regularly. As part of this process, Risk Metrics runs extensive matching programs against 3rd party data sets such as Experian, Dun & Bradstreet and others. The logical and least costly technology approach is to use data already available. In cases where there is a policy and we are looking for employee misclassification, here is a little of the logic used. First, when a policy is written the employer must report, on the policy itself, how many employees are covered. This piece of data along with the corresponding premium and total payroll clearly define the number of employees covered on a policy. All of these data elements are currently required as part of the proof of coverage record the Department of Labor and Workforce Development ("the Department") processes. Comparing data from third parties to that reported on the policy is relatively easy with the right matching algorithms/programs. When the policy clearly shows 3 employees covered, a payroll of $60,000 and corresponding premiums, but the outside business credit bureaus reports the business as a masonry contractor with annual sales of $4 million and 20 employees you have a good suspect for misclassification. It is all about letting the system identify the suspects. These ratios and benchmarks (e.g. sales per employee, average weekly payroll etc.) are well defined

by each of over 600 workers classification codes and are used by Risk Metrics to identify outliers/suspects.

Considering noncompliance and misclassification identification as a relatively close offshoot of current operations, the incremental cost born through exploring this opportunity would be through utilizing records found in existence at Experian, D&B, and other providers that appear to have no workers' compensation policy in effect or where the number of employees reportedly covered on a policy is significantly less than that reported by the national business credit bureaus. Licensing data such as this runs the cost of ranging from **$700,000-$750,000 for full data inclusion annually.** This would be a turn-key operation, with the system housed in Boca Raton, FL. It is I-Pad and I-Phone compatible for convenient field assess.

SAS

Carl Hammersburg, former state of Washington Fraud Prevention and Compliance group leader (19 years in Fraud), and Alene Arnold, state of Tennessee representative met with several members of the various committees and Kim Jefferson on September 18, 2012 to present their program. In 2012, SAS, the largest privately-held software company in the world, anticipates revenues of $3B. They have over 12,000 employees, serving 50,000 customer sites around the world, including all 50 state governments. In Tennessee, SAS currently provides services for numerous agencies, including the TBI, Tenn- Care, and the Department of Education. Some 98% of their clients renew their software each year and 70% actually buy more. SAS reinvests 25% of top line sales into research and development, which is twice the industry.

SAS successes have come from exploring data points from different angles. In Washington, SAS saved IRS data for the last phase of the project, which had a whole new set of challenges. One of their main objectives is to get rid of false positives. High sales tax revenues are red flags for low number of employees. Craig's list is another source of data that can offer leads. Washington coverage differs from Tennessee in that the former operates a monopolistic state fund. Like Ohio, the state issues their own policies and services the coverage with their own premium auditors. Thus, they likely have an advantage in detecting and controlling fraud since all their policies are managed by the state, as opposed to our situation in Tennessee where over 300 companies write workers' compensation coverage. However, SAS does have extensive experience within individual insurance companies, as well as consortium fraud approaches.

According to SAS, industries outside construction that have had a high incident rate of fraud include logging, package delivery, restaurants, trucking, and home health care.

Washington is having more and more successes through investigations with check cashing businesses. They have also found setting up workers' compensation special attorney generals' units to be effective in investigating and prosecuting fraud. They have an impressive 100%

conviction rate. Washington used Memorandum's of Understanding with all of the agencies that they dealt with. In the past, some agencies have resisted providing their data. Carl challenged agencies contentions that they couldn't provide the data with: "show me the law" that prohibits data sharing.

They have used D&B as a data source, but had very low hit ratios. What seems to be much more effective is to use integrated tasks with different disciplines. Lexis Nexis is another good source of data.

One of the keys to narrowing down the leads is utilization of a "learn and improve" cycle, which is embedded in the SAS solution. They use data from 15 programs, encompassing 5 agencies, and the IRS.

With respect to return on investment, **SAS paid for itself in Washington the first year**, although there is no guarantee that they would produce similar results in Tennessee. They discovered 700-750 unregistered business. Of those, 400-500 were registered, but involved in fraudulent activities. Their activities were not limited to the construction industry.

SAS also provides Fraud detection services to the state of Louisiana.

Initial fees to secure the SAS system are $550,000 for Workers' Compensation only, and $895,000 for Workers' Compensation and Unemployment Tax service. Annual fees after the first year are $107,800, and $175,420 respectively. Hardware costs run $118,950 annually, plus an IT tech to run the system. For SAS to host the project, costs would run $160,000-$200,000 annually.

On Point Technology, Inc.

The final system that we explored on November 6, 2012 was On Point Technology, which currently provides a software package to the Unemployment Benefits division of the DLWD. Kim Jefferson reports that if the Department is interested in this vendor, their services can be procured without having to go through a formal RFP process, since it could be included as an "add on" to their current contract.

On Point "specializes exclusively in Unemployment Insurance" and will provide the Aware Enterprise for Misclassified Workers application. According to On Point, "their software will:

- uncover misclassified worker fraud schemes
- offer advanced query and analytic capabilities via one-click audits via FraudIT
- allow non-technical users to turn workforce data into industry intelligence via the Workforce Reported
- deliver next-generation data mining through the innovative InfoBase™ technology

- conduct audits and peruse data based on any data characteristics
- and export data results into Microsoft Office applications."

They can "go live" typically in six months or less.

We discovered in their presentation that this company has not provided data mining for Workers' Compensation policies, but they were in the process of working with the state of Ohio to do just that. In their proposal, they indicate that they will allow "an additional 15 tables [that] can be imported into Workforce Reporter with Aware Enterprise for Misclassified Workers", thus accommodating our need to include NCCI and "Exemption" data.

One-Point Technology has proposed an initial software fee of $485,000, with hardware (and related) costs estimated to be $68,316. Assurance and Certification Plan membership are $50,000 for year two, and an increase of 5% annually thereafter. This offer is valid through June 30, 2013.

Recommendations

With the SAS result for the state of Washington of their system paying for itself in the first year, it is believed that a substantial portion of the costs could be recouped in penalties if the recommendation made in the 2012 report is put into law. Accordingly, we recommend that a system be procured through an RFP process. Should the system selected fall short of its goal of generating enough revenues to cover the costs, the Department would tap into the Employee Misclassification Enforcement and Education Fund. We believe that this investment should be a priority over adding staff if it gets down a choice due to limited resources. Staff can be added, if necessary, in subsequent fiscal years.

With respects to the RFP, the Development team with the Department should work the specifications to build a model in blocks based upon its priorities. Along with the state deciding what it wants, it should decide upon completion dates. There should be milestones for the development and delivery of the package, incorporating penalties if the selected vendor fails to perform. There should also be a termination clause if the Department doesn't like the progress being made. Consideration should be given to stair-stepping fees to the point that the system is completely functional. Finally, the Department should procure a system that mines the most databases.

We recommend that the Department go after the most extreme violators identified through the fraud software in order to gain as much traction on covering costs as possible.